

Status Quo Restructuring

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By Konstantin Sonin

Recent events concerning two automakers — GM and GAZ — underscore the difference in the U.S. and Russian governments' approaches to dealing with the economic crisis.

The U.S. government acted decisively. The previous GM owners were replaced, creditors received as much compensation as was possible under the circumstances, and last week the giant automaker emerged from bankruptcy proceedings. Freed of more than two-thirds of its former debt load, the company now has a fighting chance in today's difficult automobile market.

The Russian government, however, could not even carry out the first step in restructuring GAZ — removing Oleg Deripaska as the owner of the company. In addition, rather than writing off its debts, the firm was granted state guarantees on new debt.

When a company cannot meet its debt obligations and the owner is not replaced, this is always a recipe for disaster. In an economy that is functioning properly, ownership of such companies is transferred to either its creditors or to someone who can settle the demands of the company's creditors. The new owner then decides the fate of the company's managers; in some circumstances, it may choose to retain them.

But this approach is unworkable for state-owned businesses because they almost always have access to budgetary funds to pay off their creditors. In this situation, managers are always less motivated to restructure, and this is precisely why the granting of additional funds to state-owned businesses should always be accompanied by a sweeping reorganization of its top management. Without following that simple rule, the provision of state guarantees is, in effect, an even more ineffective form of support than subsidies. After receiving subsidies, managers have some form of stimulus to restructure their operations, but state guarantees are a direct invitation for a company to continue the status quo — that is, continue getting involved in the kind of unjustifiably risky projects that got them into trouble in the first place.

It requires a lot of political willpower by a country's leaders to compensate creditors and redistribute ownership of a failing state company. Dealing with politically vital enterprises that have gone bankrupt is no easy task for any government. The U.S. administration used all of its leverage to force GM creditors to agree to the terms of restructuring.

In Russia, the government's policy toward bankrupt companies has been based not on what is best for the economy, but according to what connections the company owner has with the ruling elite. GAZ and AvtoVaz, which received enormous federal funds to prop them up, are vivid examples of government inefficiency and incompetence.

Since a significant part of the world economy is in recession, Russia's economic slump — although one of world's worst — is not drawing a great deal of attention. But as soon as other countries that have efficient government institutions begin to pull out of the crisis, it will become clear that Russians should have demanded a lot more from their government.

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